No. 13045.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LINDSAY C. HOWARD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONER.

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Opinion Below.

The Findings of Fact and Opinion of the Tax Court [R. 71-82] are reported at 16 T. C. 157.

Jurisdiction.

Notices of deficiencies were mailed by the Commissioner of Internal Revenue to Petitioner on August 6, 1948, and March 31, 1949, proposing deficiencies in income and victory tax for the calendar year 1943 in the sum of $6,204.99 and in income tax for the calendar years 1944, 1945 and 1946 in the sums of $3,439.12, $2,077.84 and $5,185.25, respectively [R. 11-20, 28-29]. Petitions to the Tax Court of the United States were filed by Petitioner on November 1, 1948, and May 18, 1949, pursuant to and within the 90-day period prescribed by Section 272(a) of the Internal Revenue Code [R. 3, 5, 7-20, 24-32]. Issue was joined by the filing of the Commis-

sioner's answers on December 8, 1948, and July 5, 1949 [R. 3, 5, 20-21, 31-32].

The Tax Court's opinion (16 T. C. 157) was promulgated January 24, 1951 [R. 71-82]. On February 5, 1951, Petitioner filed a motion to correct findings of fact [R. 82-85] and a motion to reconsider the Court's opinion on the second issue [R. 85-88]; both of said motions were denied on February 12, 1951 [R. 4]. And on April 26, 1951, a decision was entered in both proceedings [R. 97-98]. Petition for Review of said decisions was filed by the Petitioner on July 23, 1951 [R. 99-104], pursuant to Section 1141 of the Internal Revenue Code and within the three months' period specified in Section 1142 of the Internal Revenue Code. Petitioner filed his income tax return for the calendar year 1943 with the Collector of Internal Revenue for the First District of California and for the calendar years 1944, 1945 and 1946 with the Collector of Internal Revenue for the Sixth District of California, all within the jurisdiction of this Honorable Court [R. 7, 20, 24, 31, 72, 103].

Questions Presented and Statutes Involved.

1. The principal issue is whether the Tax Court erred in determining that expenses for legal fees and costs incurred in defense of an action brought by Petitioner's divorced wife to collect alimony are not deductible from Petitioner's gross income. The Tax Court held the expenses to be personal in nature and hence nondeductible under Section 24(a)(1) of the Internal Revenue Code, which reads as follows:

"SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23(x);"

The Petitioner maintains, however, that said expenses were not personal in nature (as indeed the Tax Court itself has held in identical cases where divorced wives were the taxpayers seeking similar deductions); and that the expenses were allowable deductions under Section 23(a)(2) of the Internal Revenue Code, which reads as follows:

"Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses—

* * * * * * * *

(2) Non-trade or non-business expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

2. The second issue, which becomes academic if Petitioner prevails on the principal issue, is whether the Tax Court erred in failing to find, upon the basis of uncontradicted testimony, that of a legal fee paid by Petitioner to Walter McGovern on September 14, 1943, in the sum of $5,000.00, one-half was paid for legal services in successfully defending Petitioner in a Court-Martial proceeding (the Tax Court having held that fees paid in defense of such proceedings were deductible from gross income). Disregarding such uncontradicted evidence, the Tax Court erroneously held that the full $5,000.00 was paid for services rendered in the alimony litigation.

Statement of the Case.

On August 23, 1938, Petitioner and his wife, Anita Z. Howard, executed a property settlement agreement providing, in part, that the Petitioner would pay to Anita Z. Howard during her nature life, or until she remarried, a monthly sum of $1,250.00, commencing August 1, 1938 [R. 36, 72]. On November 5, 1938, Anita Z. Howard was granted a final divorce by a decree of the Second Judicial District Court of the State of Nevada in and for the County of Washoe, which decree approved, ratified and adopted in its entirety the property settlement agreement of the parties and expressly ordered and adjudged that the covenants therein contained should be performed [R. 36, 72].

Petitioner made the payments to Anita Z. Howard of $1,250.00 per month, as specified in the property settlement agreement, from August, 1938, through the calendar year 1941, and then discontinued such payments [R. 36, 73].

Thereupon, Anita Z. Howard commenced an action against Petitioner in the Superior Court of the State of California in and for the City and County of San Francisco, to recover the monthly payments alleged to be due her under the property settlement agreement, and praying that the Nevada decree be established as a foreign judgment and enforced by order of the California Court [R. 36, 73].

Petitioner filed an "Answer and Cross-Complaint" in the action, denying liability upon two grounds:

(a) That Anita Z. Howard had remarried under common law and hence his obligation to make monthly payments had terminated under the terms of the property settlement agreement; and

(b) That the property settlement agreement was null and void, having been procured by the fraud and deceit of Anita Z. Howard, in that during their married life, and prior to the execution of the agreement, she had represented to Petitioner that she had been a faithful wife, whereas in truth and fact for four years prior to the execution of the agreement she had been an unfaithful wife to Petitioner, unbeknownst to him [R. 36, 73].

The cross-complaint prayed for the cancellation and annulment of the property settlement agreement and that portion of the decree of the Nevada Court which purported to approve and adopt the same [R. 37, 74].

Anita Z. Howard filed a demurrer to the Answer and Cross-Complaint, which was sustained by the Superior Court. The decision was reversed by the District Court of Appeal, First District, Division 2, California, on April 24, 1945, in *Howard v. Howard,* 157 P. 2d 874, but was affirmed by the Supreme Court of California on November 27, 1945, in *Howard v. Howard,* 163 P. 2d 439 [R. 36, 74].

Petitioner was commissioned a Captain in the United States Army Reserve on or about April 27, 1942. On or

about November 20, 1943, a General Court-Martial was appointed to try Petitioner on the charge of Conduct Unbecoming an Officer and a Gentleman. Said General Court-Martial tried the case and on December 14, 1943, Petitioner was found not guilty and was acquitted of the charge [R. 38, 74].

As attorneys' fees, expenses and court costs in said Court-Martial proceedings and in said litigation in the Superior Court, District Court of Appeal and Supreme Court of California, Petitioner paid the following amounts [R. 39, 75-76]:

1943

Date of Check	To Whom Issued	Check No.	Amount
2-23-43	Hart & Hart	7737	$ 52.00
3-16-43	Walter McGovern	7761	197.00
5-5-43	Williams & Williams	7790	25.00
5-17-43	Hart & Hart (Shorthand, etc., in re deposition)	7804	13.09
6-17-43	Walter McGovern	7830	63.75
8-5-43	Baker, Selby & Ravenel (Attorneys in Washington)	7855	522.80*
9-14-43	Walter McGovern	7890	5,000.00
12-7-43	Walter McGovern (Services of Edward Bergner)	7984	79.50
12-13-43	Walter McGovern (Disbursements—Howard v. Howard)	7991	489.34
12-16-43	Walter McGovern (Expense of Howard v. Howard)	7995	525.43
12-23-43	Walter McGovern	8004	50.00
12-29-43	Walter McGovern	8013	3,000.00*
			$10,017.91

1944

Date of Check	To Whom Issued		Check No.	Amount
1-4-44	Walter McGovern		8017	$ 253,73
2-1-44	Walter McGovern		8036	195.75
3-27-44	Crocker 1st National Bank (*In re* Howard v. Howard)		8069	150.00
3-31-44	Gus Ringole		8074	2,550.00*
4-3-44	Otton J. Bauer [Howard v. Howard—Transcript on Appeal]		8078	265.00
4-3-44	Walter McGovern (Telephone—Howard v. Howard)		8077	31.26
5-3-44	Notary Fee		Petty Cash	.50
5-4-44	Fee to file revocation of Power of Attorney No. 8092	$10.00		
	Refund	7.00		3.00
6-12-44	Notary fees		8110	2.00
				$ 3,451.24

1946

To Whom Issued	Amount
Walter McGovern	$ 5,000.00
Printing petition for rehearing	92.21
Costs in trial court	196.80
Costs on appeal	100.00
Release of attachment	2.00
Recording satisfaction of judgment	2.00
	$ 5,393.01

The Tax Court held that the expenses for legal fees and costs incurred in defense of the action brought by Petitioner's divorced wife to collect alimony are not deductible from Petitioner's gross income as a non-business expense on the ground they are personal in nature. In addition the Tax Court held that the expenses for legal fees and costs incurred by the Petitioner in defense of the Court-Martial proceedings are deductible as a business expense and found as fact that such expenses were incurred in the amount of $3,522.80 in 1943 and $2,550.00 in 1944, being the three items asterisked above. But, as heretofore stated, the Court refused to allocate one-half of the $5,000.00 fee paid on September 14, 1943, to the Court-Martial proceedings.

Points Relied On.

1. The Tax Court's conclusion in the instant case that the expenses for legal fees and costs incurred in the defense of an action brought by Petitioner's divorced wife to collect alimony are personal in nature is erroneous in view of its decision in two other cases, wherein the Tax Court denied similar expenses incurred by a divorced wife to obtain an increase in alimony were personal in nature.

2. The evidence is uncontradicted that Petitioner paid the sum of $5,000.00 to Walter McGovern, his attorney, on September 14, 1943, one-half of which was for services in connection with the Court-Martial proceedings.

3. A finding of fact shall be set aside where, after due regard is given to the opportunity of the Trial Court to judge the credibility of the witness, the finding is clearly erroneous.

ARGUMENT.

I.

Legal Fees and Expenses Incurred by a Divorced Husband in Resisting His ex-Wife's Suit for Alimony Are Deductible as Ordinary and Necessary Expenses Incurred in the Production or Collection of Income or in the Management, Conservation and Maintenance of Property Held for the Production of Income. Said Fees and Expenses Are Not Personal Expenses.

In I. T. 3856, 1947-1 C. B. 23, the Bureau of Internal Revenue considered the question whether counsel fees (1) paid by a wife in attempting to obtain an increase in alimony and (2) paid by a husband in resisting such an increase would be deductible for tax purposes. Without distinguishing between husband and wife, and solely in reliance upon early Board of Tax Appeals' cases, the Bureau ruled that such fees were not deductible by either spouse for the reason that such fees of both parties were personal expenses, since they arose out of the marital relationship.

I. T. 3856, however, has now been reversed by the Tax Court insofar as it had to do with legal fees paid by a wife to secure alimony or obtain an increase in alimony.

In *Elsie B. Gale,* 13 T. C. 661 (aff'd 1951 P-H para. 72,532 (C. C. A. 2, July 24, 1951)), where the divorce had been obtained in 1940, the ex-wife during 1944 paid attorneys' fees of $4,000.00 for services rendered in 1943 and 1944 in obtaining an increase in alimony. The ex-wife argued that the expense was incurred for the collection of income, but the Commissioner sought to deny the deduction upon the ground that the expense was per-

sonal, as shown by the following statement of the Court on page 667:

> "* * * On the other hand, the respondent argues that such expense arose out of the marital relationship existing between the petitioner and her husband and, therefore, constituted purely personal and family expenses, the deduction of which is expressly prohibited by section 24(a)(1) of the code."

The Court, in a reviewed opinion without dissent on this point, held that the fees were deductible, rejecting the Commissioner's argument that the expenses were personal with the following statements:

> "Under the facts of the instant case, it is unnecessary to discuss at length respondent's argument that the lawyers' fees in question were personal and family expenses within the meaning of section 24(a)(1). The cases relied on by the Commissioner on brief and in I. T. 3856, 1947-1 C. B. 23, are distinguishable either on the facts presented or by the circumstance that neither section 23(a)(2) nor section 22(k) was part of the revenue laws when the cases were decided. *Cf. David G. Joyce,* 3 B. T. A. 393; *Henry Sanderson,* 23 B. T. A. 304; affd., 63 Fed. (2d) 268; *Fred S. Markham,* 39 B. T. A. 465; *Ralph D. Hubbart,* 4 T. C. 121; *Mildred A. O'Connor,* 6 T. C. 323. Moreover, the evidence shows that the legal expense incurred by the petitioner herein was solely for the purpose of producing or collecting increased alimony for past and future years and *was in no respect paid in connection with the personal marital difficulties of petitioner and her husband, which had been settled by separation and divorce over three years before the suit in question was commenced by the petitioner.* * * *" (Emphasis added.)

Similarly, in the present case, any personal marital difficulties of petitioner and his ex-wife had been settled by divorce on November 5, 1938 [R. 36], more than three years before the start of the controversy giving rise to the expenses in question here. We desire to emphasize that here, as in the *Gale* case, the later litigation over alimony had nothing whatever to do with the divorce. As the Supreme Court of California stated in *Howard v. Howard,* 163 P. 2d 439, 440—

> "* * * Defendant filed an answer and cross-complaint attacking the money provisions, but not the divorce provisions, of the Nevada decree * * *"

and—

> "Defendant concedes that the divorce provisions of the Nevada decree are not open to attack * * *."

Hence, here as in the *Gale* case, the litigation was concerned only with the ex-wife's attempt to collect alimony and the husband's efforts to resist the collection.

On the same day the *Gale* case was promulgated the Tax Court, in a unanimous reviewed opinion, also decided the case of *Barbara B. LeMond,* 13 T. C. 670. The wife in that case paid counsel fees of $7,500.00 and $3,000.00 during the years 1943 and 1944, respectively, for services in negotiating a financial settlement and separation agreement. These fees were not for services in obtaining a divorce, which was obtained in 1943. The Court held that 80 per cent of the fees were deductible, since that was the percentage of the total alimony to be received under the agreement that would be taxable to the wife.

And in concluding its opinion the Court made this pertinent observation at page 674:

> "* * * the attorneys to whom the fees in question were paid were solely concerned with the financial aspects of the separation, rather than with the settlement of the personal or marital difficulties of the petitioner and her husband. Therefore, it is our opinion that no part of the legal expenses herein constituted personal family expenses and that no allocation of the legal fees in that respect is necessary."

In view of these authorities it is incomprehensible to counsel for the Petitioner how the Tax Court can hold that expenses incurred by a divorced wife, in the type of controversy here involved, are not personal and yet hold that expenses of the same character are "personal expenses" if incurred by a divorced husband, particularly where both parties incur the expenses in the same identical controversy. Since deductions of the fees and expenses should not be disallowed as personal expenses under Section 24(a)(1) of the Internal Revenue Code, which is the only ground for disallowance advanced by the Tax Court, the only remaining question is whether the deductions are authorized in the case of the husband by Section 23(a)(2) of the Code.

Although there is no suggestion that Respondent contends that the expenses incurred by Petitioner for fees and costs are other than "ordinary and necessary," such expenses have long been established as being both "ordinary" and "necessary" within the meaning of those terms as used in Section 23(a)(1) of the Code. (*Kornhauser v. United States,* 276 U. S. 145; *Welch v. Helvering,* 290 U. S. 145.) The Supreme Court stated in the *Welch*

case that though a lawsuit may happen only once in a lifetime, nonetheless, "the expense is an ordinary one, because we know from experience that payments for such purposes, whether the amount is large or small, are the common and accepted means of defense against attack."

Traditionally, alimony was deemed to be an allowance for the nourishment of a wife *out of the income of the husband*. This concept has been adopted in the Internal Revenue Code by the enactment of the alimony amendments in the Revenue Act of 1942. Pursuant to said Act, Section 22(k) of the Code has provided in effect that monthly payments of alimony under a decree of divorce to a divorced wife "shall be includible in the gross income of such wife"; and, correspondingly, Section 23(u) of the Code has authorized a deduction from the gross income of the husband of amounts thus "includible under Section 22(k) in the gross income of his wife * * *." In recommending such amendments, the Senate Finance Committee stated in its report (Senate Report No. 1631, 77th Cong., 2nd Session, 1942-2 C. B. 568):

> "These amendments are intended to treat such payments as income to the spouse actually receiving or actually entitled to receive them and to relieve the other spouse from the tax burden upon whatever part of the amount of such payments is under the present law includible in his gross income. * * *"

The property settlement agreement in the instant case shows that the parties contemplated the payment of alimony from Petitioner's income and had reference to the prospective amount of such income in determining the

monthly sum agreed upon. Thus, the parties agreed [R. 42-43]:

> "That the first party and her counsel are fully advised that the income of the second party is derived in large measure from the automobile industry, that they have had access to his accounts and records and are informed as to the past and present income and that the provisions hereinafter made for the support and maintenance of the first party and their children are made advisedly and with full knowledge that the income of said second party is subject to extreme fluctuation."

In other words, the parties contemplated that Petitioner would realize income and would pay $1,250.00 of it monthly to his ex-wife; and in resisting continued payments after 1941 Petitioner was attempting to retain his entire income. This is precisely the contemplation now held in the Code regarding alimony payments: if they are paid they are included in the wife's gross income and are deductible from the husband's gross income, whereas if he does not pay them there, of course, is nothing to include in the wife's gross income and the husband's gross income is not diminished.

The significance of the above facts lies in the principle established by the Tax Court that expenses incurred in an effort to *retain* taxable income are as much deductible as are those incurred in producing the income in the first instance. In *William A. Falls,* 7 T. C. 66, attorneys' fees for defending the right to retain income received from the use of patents were held deductible on the ground that such expenditures were for the "production or collection of income." The Court stated at page 71:

> "The royalties were collected as income and presumably were reported as income by petitioner and

his associates in the years in which received. As stated in *Estate of Frederick Cecil Bartholomew,* 4 T. C. 349, 359 (appeal dismissed, 151 Fed. (2d) 534):

> '* * * It seems reasonable to hold that any litigation which sought to increase the production of income, or to protect the right to income produced, being produced, or to be produced, or to prevent others from acquiring a right, title, or interest, therein would be proximately related to "the production or collection of income" specified in section 121. * * *' "

The Petitioner maintains that, as applied to the present case, the controversy in essence was who was entitled to a certain portion of his taxable income; and inasmuch as the wife's attorneys' fees would be deductible in attempting to collect such taxable income, the husband's attorneys' fees in attempting to retain such taxable income are also deductible.

It is also significant that at the time Anita Z. Howard commenced her action against the Petitioner she obtained writs of attachment or garnishment with respect to the Petitioner's business and the house which he had held for rental or sale ever since the divorce [R. 60]. In resisting such demands Petitioner contends that he was attempting to maintain and conserve the income-producing property that was thus attached or garnished.

In view of the foregoing we respectfully submit that the fees and expenses incurred by Petitioner in defense of the alimony action are deductible as non-trade or non-business expenses within the meaning of Sections 23(a)(2) of the Internal Revenue Code.

II.

The Tax Court Erred in Its Findings of Fact in Respect to the Amounts Incurred and Paid as Legal Expenses in Connection With the Court-Martial Proceedings, Which Amounts the Lower Court Held Were Deductible as Business Expenses.

The Tax Court found, among other things,

> "that petitioner incurred and paid legal expenses in the amount of $3,522.80 in 1943 and $2,550.00 in 1944 in connection with the Court Martial proceedings * * *."

The evidence in this proceeding is uncontradicted that in addition to said amounts the Petitioner paid the sum of $5,000.00 to Walter McGovern on September 14, 1943, one-half of which was for services in connection with the Court-Martial proceedings. This Honorable Court's attention is respectfully directed to the following testimony of the Petitioner on direct and cross-examination [R. 58-59; 64-65]:

> "Q. I call your attention to the next one, which is a payment dated September 14, 1943, a $5,000 by check 7890 issued to Walter McGovern; and I will ask you if Walter McGovern was your attorney? A. He was.
>
> Q. Did he represent you both in the civil suits as well as in the court-martial? A. That's correct.
>
> Q. Do you have any recollection as to what that was paid for, that $5,000? A. The $5,000 was for expense on the court-martial and the civil case, and also as a retainer in both cases.
>
> Q. Can you make any allocation or any recollection of what portion of that was for court-martial and what portion for the other? A. Well, my judgment would be that it was about half and half.
>
> Q. I see. He was handling both cases at the same time? A. That's right." [R. 58-59.]

"Q. Then in September you testified—September 14, 1943—you paid $5,000 to Walter McGovern. Was your testimony that that was partly for the court-martial and partly for the civil suit? A. That's correct.

Q. How do you know? A. Mr. McGovern told me that.

Q. Did he render you any statement for that $5,000? [15] A. He did.

Q. Did he segregate it as between the court-martial proceedings and the civil proceedings? A. No, he didn't.

* * * * * * * *

Q. (By Mr. Melville): The court-martial proceedings wasn't entitled Howard versus Howard? [16] A. They were as far as Mr. McGovern was concerned. All his bills were made out the same way." [R. 64-65.]

Thus, we have uncontradicted testimony that of the $5,000.00 paid to Walter McGovern on September 14, 1943, one-half (or $2,500.00) was charged by the attorney and paid by Petitioner for services rendered in connection with the Court-Martial proceedings. This fact is not contradicted at all by the circumstance that the entry book of account reflects payment of $5,000.00 to Walter McGovern for legal services in *Howard v. Howard.* The testimony of Petitioner shows that said attorney included his services in connection with the Court-Martial proceedings with those he entitled *"Howard v. Howard,"* because, as the Tax Court found [R. 74], the Court-Martial proceedings were instigated at the behest of the divorced wife and hence, in a broad sense, grew out of and were part of *"Howard v. Howard."* We respectfully submit that the Tax Court was bound by Petitioner's uncontradicted testimony.

III.

A Finding of Fact Shall Be Set Aside Where, After Due Regard Is Given to the Opportunity of the Trial Court to Judge the Credibility of the Witness, the Finding Is Clearly Erroneous. Said Finding That All of the $5,000.00 Paid by Petitioner to Walter McGovern Is Solely in Connection With the Civil Litigation, Is Clearly Erroneous.

The effect of Section 1141(a) of the Internal Revenue Code providing that jurisdiction of the Court of Appeals to review decisions of the Tax Court shall be in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury, is to read into said Section the Federal rule that findings of fact shall not be set aside unless clearly erroneous, and that due regard shall be given to the opportunity of the Trial Court to judge the credibility of the witnesses. (*Grace Bros. v. Commissioner* (C. C. A. 9, 1949), 173 F. 2d 170.)

The Supreme Court has said that, "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." (*United States v. U. S. Gypsum Co.,* 333 U. S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746.) The rule has long been established that uncontradicated testimony must be followed. (*Chesapeake & Ohio Railway Company v. Martin,* 283 U. S. 209, 216, 217, 51 S. Ct.

453, 75 L. Ed. 983; *San Francisco Association for Blind v. Industrial Aid for the Blind,* 152 F. 2d 532, 536.)

It is respectfully submitted that Petitioner's testimony, that one-half of the sum of $5,000.00 paid to Walter McGovern was incurred in connection with the Court-Martial proceedings, is uncontradicted, and that the Tax Court's finding or determination that all, or any amount in excess of one-half, of said sum was incurred in connection with the civil litigation is not supported by substantial evidence, or any evidence at all, and is clearly erroneous.

Conclusion.

There is no substantial evidence or evidence legally sufficient to sustain the finding of the Tax Court that Petitioner paid all, or any amount in excess of one-half, of the sum of $5,000.00 to Walter McGovern in connection with the civil litigation. The finding is arbitrary.

In arriving at the finding the Tax Court ignored the unimpeached and uncontradicted testimony of the Petitioner, which, if considered at all, would preclude such a finding. Evidence which is material, relevant, probable, consistent, uncontradicted and not discredited cannot be disregarded or ignored by the Trial Court. In addition, the Tax Court's decision that the expenses incurred by Petitioner in connection with the civil litigation are not deductible on the ground that they are personal in nature is erroneous as a matter of law and must be reversed. The decision is arbitrary in view of the Court's earlier

decisions that legal fees paid by an ex-wife to obtain alimony are not personal in nature and are deductible as a non-business expense.

Dated October 31, 1951.

Respectfully submitted,

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